

SUMMARY ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Kuehl Analyst: Colin Stevens Bill Number: AB 2692

Related Bills: See prior analysis Telephone: 845-3036 Amended Date: 5/13/98

Attorney: Doug Bramhall

Sponsor:

SUBJECT: Depreciation Deduction/Ultra-Low Emission Vehicles Have a Class Life of 3 Years and Expense Leased ULEVs

- x DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as amended APRIL 29, 1998.
- AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.
- AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended .
- x FURTHER AMENDMENTS NECESSARY.
- DEPARTMENT POSITION CHANGED TO .
- x REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED APRIL 29, 1998, STILL APPLIES.
- OTHER - See comments below.

SUMMARY OF BILL

Under the Personal Income Tax Law (PITL) and the Bank and Corporation Tax Law (B&CTL), this bill would:

- provide that automobiles certified by the California Air Resources Board (CARB) as having emissions that meet or are lower than the standard for ultra-low emission vehicles (ULEV) would be depreciated over three years without regard to certain dollar limitations on the amount of depreciation that may be taken; and
- allow a taxpayer to elect to expense the total cost of the full term of a lease of an ULEV in the first year of the lease.

SUMMARY OF AMENDMENT

The May 13, 1998, amendment adopts suggestions proposed in the Franchise Tax Board's analysis of the bill as introduced February 23, 1998. The amendment:

- Defines an ultra-low emission vehicle and refers to that definition in describing vehicles that would be allowed the accelerated recovery period.
- Clarifies that the accelerated depreciation or expensing provisions for qualified ULEVs would apply to property placed in service on or after January 1, 1998, rather than to taxable or income years beginning on or after that date, so that a single depreciation schedule may be used for the life of the property.
- Provides stand-alone language to the B&CTL provision to specify a three-year recovery period for ultra-low emission vehicles and that allowable depreciation would not be limited by provisions of the Internal Revenue Code relating to limitations on depreciation for certain "luxury" automobiles.

Board Position:

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Department/Legislative Director

Date

Johnnie Lou Rosas

6/24/98

Other than the amendments described above, the department's analysis of the bill as amended April 29, 1998, still applies. The remaining policy and implementation concerns are stated below for convenience.

EFFECTIVE DATE

This bill would take effect when chaptered and would apply to property placed in service on or after January 1, 1998, and before December 1, 2003. Because the bill's provisions are transactionally effective (on the "placed-in service" date), this bill would apply to the 1998 calendar months of a taxpayer's 1997 fiscal year.

Policy Considerations

This bill would allow a taxpayer to expense, in the first year of a lease, the total cost of the full term of the lease. However, unlike other expensing provisions (such as Internal Revenue Code Section 179) and the state Manufacturer's Investment Credit, this bill provides no recapture provision so that it would be possible for a taxpayer not to complete the full term of the lease, yet be allowed to deduct more than the amount actually paid on the lease. Inclusion of a recapture provision would ensure that taxpayers are not allowed to deduct an amount greater than the expenses actually paid on the lease. Amendments 1 and 3, as requested by the author, would provide a recapture equal to the unpaid portion of the lease in the year the ULEV is disposed of. In addition, a penalty, graduated based on the number of years, is provided at the request of the author's office to represent an approximation of the time value of money with respect to the accelerated deduction.

The latter amendment raises a new policy consideration since no other recapture provision includes such penalty, including such potentially valuable credits as the Manufacturer's Investment Credit. This bill would create additional differences between federal and California law regarding depreciation, increasing the complexity of completing a California tax return.

This bill does not limit the accelerated deduction for leased property to only the initial lessee of a ULEV. Therefore, it is possible that the initial lessee could expense the total cost of the full term of the lease in the first year and lease the ULEV to another taxpayer, who also would be able to deduct the cost of his or her lease. However, staff at the author's office requested amendments 1 and 3 to allow only a lessee who does not sublease the vehicle to expense the total cost of the full term of the lease.

Although it appears that this bill is intended to allow a lessee to expense the cost of a lease in the first year, the bill provides the special treatment to a taxpayer, but does not state whether the expensing provision also might apply to a lessor who is itself leasing ULEVs from manufacturers to lease to consumers. Amendments 1 and 3, requested by staff at the author's office would allow only the actual user of the ULEV to expense the total cost of the full term of the lease.

Implementation Considerations

This bill would allow a taxpayer to deduct the "total cost of the full term of a lease" in the first year of the lease. However, it currently is unclear whether the "total cost" would include the normal ancillary expenses such as maintenance and repairs, interest, insurance, and taxes, depreciation or only the amount of scheduled lease payments attributable to capital costs or some other identifiable amount. In addition, there is also a "cost of money" (i.e., interest) element that is reflected in gross lease payments on which a taxpayer could receive an immediate deduction. Amendments 1 and 3, requested by the author's office, clarify that, under the "qualified lease amount," any amounts for which a taxpayer is unconditionally obligated under the terms of the lease would qualify for expensing in the first year. This amount could include interest, maintenance, taxes or any other costs for which a taxpayer is unconditionally obligated.

To implement this bill the FTB would need certification by the CARB that a vehicle meets the standards for ULEVs. However, this bill does not require: that CARB provide to the FTB information regarding vehicles certified as meeting ULEV standards or provide a certification to taxpayers identifying a vehicle as a ULEV, that taxpayers retain a certification of a vehicle as a ULEV, or that taxpayers present any certification to the FTB upon request. However, CARB does post information regarding vehicles that qualify as ULEVs, which the department could use to determine eligibility under this bill.

Analyst Colin Stevens
Telephone # 845-3036
Attorney Doug Bramhall

FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO AB 2692
As Amended May 13, 1998

AMENDMENT 1

On page 3, strike lines 16-21 and insert:

(b)(1) For leased property that is described in subdivision (a), a qualified taxpayer may elect to treat the qualified lease amount as an expense that is not chargeable to capital account and that is paid or incurred in the year in which the lease term commences.

(2) For purposes of this subdivision:

(A) The "qualified lease amount" shall be equal to the total payments for which the taxpayer is unconditionally obligated under the written terms of the lease.

(B) The "lease term" shall be equal to the original stated term of the lease, exclusive of any lease renewal options.

(C) A "qualified taxpayer" shall be any lessee who is the end user of any property described in subdivision (a), but shall not include any lessor, nor shall it include any lessee who subleases property described in subdivision (a) to another lessee.

(3) If, at any time prior to the expiration of the lease term, the qualified taxpayer either disposes of the property described in subdivision (a) that is subject to the lease, or otherwise terminates the lease, then the qualified taxpayer shall:

(A) in the case where the disposition or termination occurs within the same taxable year that the lease term commences, no election shall be permitted under this subdivision, or

(B) in the case where the disposition or termination occurs in a taxable year other than the taxable year in which the lease term commences, add the recapture amount (as determined under paragraph (4) of this subdivision) to the qualified taxpayer's taxable income for the year in which the disposition or termination occurred.

(4) For purposes of this subdivision, the "recapture amount" shall be equal to the sum of the following:

(A) The amount determined by multiplying the qualified lease amount by a fraction, the numerator of which is equal to the number of months remaining in the lease term (determined as of the date of the disposition or termination occurs), and the denominator of which is equal to the total number of months in the lease term, and

(B) An amount equal to the product of the amount determined under subparagraph (A) of this paragraph multiplied by the percentage specified in the following table:

For dispositions occurring less than 12 months after the date of commencement of the lease term	5 percent
For dispositions occurring 12 months or more after the date of commencement of the lease term but less than 24 months after commencement of the lease term	10 percent
For dispositions occurring 24 months or more after the date of commencement of the lease term but less than 36 months after commencement of the lease term	15 percent
For dispositions occurring 36 months or more after the date of commencement of the lease term but less than 48 months after commencement of the lease term	20 percent
For dispositions occurring 48 months or more after the date of commencement of the lease term but less than 60 months after commencement of the lease term	25 percent
For dispositions occurring 60 months or more after the date of commencement of the lease term	30 percent

AMENDMENT 2

On page 3, line 34, after "repealed." insert:

However, the recapture provisions in subdivision (b) shall continue to apply until the expiration of the lease term.

AMENDMENT 3

On page 4, strike lines 30-35 and insert:

(b)(1) For leased property that is described in subdivision (a), a qualified taxpayer may elect to treat the qualified lease amount as an expense that is not chargeable to capital account and that is paid or incurred in the year in which the lease term commences.

(2) For purposes of this subdivision:

(A) The "qualified lease amount" shall be equal to the total payments for which the taxpayer is unconditionally obligated under the written terms of the lease.

(B) The "lease term" shall be equal to the original stated term of the lease, exclusive of any lease renewal options.

(C) A "qualified taxpayer" shall be any lessee who is the end user of any property described in subdivision (a), but shall not include any lessor, nor shall it include any lessee who subleases property described in subdivision (a) to another lessee.

(3) If, at any time prior to the expiration of the lease term, the qualified taxpayer either disposes of the property described in subdivision (a) that is subject to the lease, or otherwise terminates the lease, then the qualified taxpayer shall:

(A) in the case where the disposition or termination occurs within the same income year that the lease term commences, no election shall be permitted under this subdivision, or

(B) in the case where the disposition or termination occurs in a income year other than the income year in which the lease term commences, add the recapture amount (as determined under paragraph (4) of this subdivision) to the qualified taxpayer's taxable income for the year in which the disposition or termination occurred.

(4) For purposes of this subdivision, the "recapture amount" shall be equal to the sum of the following:

(A) The amount determined by multiplying the qualified lease amount by a fraction, the numerator of which is equal to the number of months remaining in the lease term (determined as of the date of the disposition or termination occurs), and the denominator of which is equal to the total number of months in the lease term, and

(B) An amount equal to the product of the amount determined under subparagraph (A) of this paragraph multiplied by the percentage specified in the following table:

For dispositions occurring less than 12 months after the date of commencement of the lease term	5 percent
For dispositions occurring 12 months or more after the date of commencement of the lease term but less than 24 months after commencement of the lease term	10 percent
For dispositions occurring 24 months or more after the date of commencement of the lease term but less than 36 months after commencement of the lease term	15 percent
For dispositions occurring 36 months or more after the date of commencement of the lease term but less than 48 months after commencement of the lease term	20 percent
For dispositions occurring 48 months or more after the date of commencement of the lease term but less than 60 months after commencement of the lease term	25 percent
For dispositions occurring 60 months or more after the date of commencement of the lease term	30 percent

AMENDMENT 4

On page 5, line 9, after "repealed." insert:

However, the recapture provisions in subdivision (b) shall continue to apply after the repeal date until the expiration of the lease term.